

BLEEDING BELARUS: ECONOMIC OUTLOOK AFTER THE ENERGY CONFLICT WITH RUSSIA

I. Changes of the situation in 2007

We start the analysis with the explanation how the situation was changed for Belarus in 2007 in comparison with 2006, i.e. after signing the new contract with Gazprom and agreements about sharing of the export duty on oil products exported by Belarus.

Table 1: Changes of the situation after signing the gas contract for 2007

2006	2007
<ul style="list-style-type: none"> • Belarus imported 21 bcm of gas from Russia • Gas transit through the country amounted to 41 bcm, from which 14 bcm was transited through Beltransgaz, and the rest 27 bcm through Russian Yamal-Europe pipeline • Belarus bought gas for USD 46.68 per tcm • The transit price through the Beltransgaz pipeline amounted to USD 0.75 per tcm of gas per 100 km and USD 0.36 per tcm through the Russian Yamal-Europe pipeline 	<ul style="list-style-type: none"> • The price for gas increased to USD 100 per tcm, • The price of transit through Beltransgaz amounted USD 1.45 tcm of gas per 100 km. • The price of transit through Yamal-Europe amounted USD 0.43 tcm of gas per 100 km • Belarus will sell Russia 50% of Beltransgaz for USD 2,500 m (by equal shares over 4 years)

Table 2: Changes of the situation after the signing the oil agreement

2006	2007
<ul style="list-style-type: none"> • Belarus imported 21.2 m ton of crude oil from Russia • Belarus exported USD 14.7 m ton oil products • The import price for crude oil was USD 231 per ton (USD 31.6 per barrel), the average export price for oil products was USD 460 (USD 63 per barrel) • Belarus set up the export duty on export of oil product at USD 57 (USD 75.8 from the end of November). However, VAT paid by Belarusian importers for Russian oil should be returned to them when they export oil products produced from imported oil. But instead they paid the lower export duty at the rate of about USD 10 per ton, as the rest was collected in the form of VAT for imported oil • Russia did not set up the export duty on crude oil exported to Belarus • Since the price for Russian oil for Belarus was about USD 180 less than for other countries, the refinery processing in Belarus yielded $180 * 21.2 = \text{USD } 3,821 \text{ m}$ of 'superprofit' 	<ul style="list-style-type: none"> • In the beginning of 2007, Russia decreased its export duties on crude oil from USD 180 to USD 172. For Belarus this duty is set up with 'corrective coefficient' of 0.293 in 2007, i.e. about USD 50 per ton • According to the agreement, Belarus will set up the export duty for oil products equal to Russian one. The average weighted export duty in Russia for oil products was USD 108 • Since the price for Russian oil for Belarus is USD 122 (172-50) less than for other countries, the refinery processing in Belarus yielded $122 * 21.2 = \text{USD } 2,582 \text{ m}$ of 'superprofit'

2. The economic impact of new gas and oil agreements

It is assumed that the economic impacts of gas price increase and new agreement on oil with Russia do not be influenced by other facts such as raise Russian protectionism against Belarusian goods, relative exchange rates, and all other possible shocks that in reality can affect of the economy under study during 2007.

2.1. Consequences for the state budget

The total losses of the budget will be USD 77.7 m or 0.4% of revenues of the general government (see Tables 3–4).¹ The Minister of Finance officially declared the necessity to reduce the budget expenditure by 5%.

Table 3: Oil (USD m)

	2006	2007	+/-
VAT	1234	475	-759
Excise tax	847	340	-507
Export duty	177	1592	1415
Development Fund at the State Budget	466	--	-466
Profit tax from two refinery	300	50	-250
Total	3024	2457	-567

Table 4: Gas (USD m)

	+	-
Beltransgaz	625	--
VAT	202	--
Compensation for households	--	48
Budget subsidies for energy sector	--	290
Total	827	338
	489	

2.2. Consequences for the balance payments

Increase in negative trade balance (goods and services) caused by the price increase for oil and gas is equal to USD 2,276 m, including net outflow of USD 1,059 m because of the higher gas price (taking into account higher price for transit), and net outflow of USD 1,217 m because of lower world price for oil products and higher price for imported oil.

In 2007, Russia should make the first payment for Beltransgaz (USD 625 m), which means the inflow of resources on financial account. Thus, the total net outflow of resources on the current and financial accounts of the balance of payments caused by gas and oil shock would be equal to USD 1,651 m.

2.3. Consequences for currency market and exchange rate

Such deterioration of balance of payments would cause adequate changes on the currency market. According to the assumption of unchanged currency revenues from oil products exports, annual positive balance on the residents' segment of the market would be equal to USD 700–800 m, annual deficit on the non-residents' segment of the market would amount USD 650–700 m, and on the households' segment of the market deficit would reach about USD 600–700 m. In case of deterioration of the currency revenues, the gross deficit might be higher, which furthermore might be strengthened by increasing demand on the households' segment of the market.

Nevertheless, external stability (i.e. exchange rate peg) is a crucial factor for the stability in monetary sphere and domestic demand; therefore we suppose that the NBB would continue maintaining of the current peg. As the volume of official reserves and possible external borrowing by the government and commercial banks are likely to exceed the volume of the supposed deficit on the currency market, we expect stability of the exchange rate and absence of devaluation as most likely scenario.

¹ According the preliminary estimations made by the Ministry of Finance, the budget losses will be around USD 200 m.

2.4. Influence on economic growth

From the demand side, we expect slower growth (or even decline) of investment. There are the following assumptions, which led us to this conclusion:

- First, the government (at least for this year) would prefer to maintain certain increase of household incomes. Thus, **enterprises** would have to carry the burden of higher costs of energy in addition to labor costs. Hence, they have no choice but to reduce their investment expenditures.
- Second, the **government** would need more resources to subsidize enterprises which would face financial difficulties, and to maintain major social expenditures. Thus, it has to restrict its investment programs.
- Third, **banks** would likely not be able maintain the same rate of crediting the economy as in 2006, as they could face certain problems with attraction of resources from households. Additionally, the NBB will not increase refinancing of banks, as this would lead to destabilization in the money market. Thus, such an important source of investment as bank loans would be limited.
- Finally, in 2007, increase in utilities prices looks very likely. This means that their share in **household** expenditures will increase, reducing the share of their investment expenditures.

According to our estimates, decrease in investment activity may cost about 3–5 percentage points of GDP increase. Thus, in 2007 we expect GDP growth rate at 5–7%.

2.5. The new prices for consumers

We expect that the new price for electricity would lead to decrease in the profitability of enterprises and deteriorate their competitiveness in trade with the outside world. According to the government's plans, enterprises should pay the price for electricity almost equal to European average, while the energy efficiency of Belarusian economy is 2.5 times less than, for example, in Germany.

Table 5: Industry

2006		2007
6.7 US cents	Electricity	8.65 US cents (European average 9.1 US cents)
70 USD	Gas	120.3 USD

Table 6: Households

2006		2007
4.17 US cents per kWh	Electricity	5.00 US cents per kWh
14.07 US cents per gigacalories	Heating	15.76 US cents per gigacalories
USD 95 per 1 tcm	Gas	USD 114 per 1 tcm

Households will not suffer a lot from the new prices on energy and heating, at least in the short-run. We suppose that the Belarusian government would keep the policy of putting the burden of the energy shock on the shoulders of enterprises.

Minsk, January, 2007